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No. 82-837

In the Supreme Court of the United States

OCTOBER TERM, 1982

ARTHUR YOUNG & COMPANY, CROSS-PETITIONER

v.

UNITED STATES OF AMERICA

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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TABLE OF AUTHORITIES

Page

Cases:

CAB v. *Hermann*, 353 U.S. 322 6

Donaldson v. *United States*, 400 U.S. 517 6

FTC v. *American Tobacco Co.*, 264 U.S. 298 ... 3

Fisher v. *United States*, 425 U.S. 391 6

Foster v. *United States*, 265 F. 2d 183 6

Hubner v. *Tucker*, 245 F.2d 35 6

Oklahoma Press Publishing Co. v. *Walling*, 327 U.S. 186 3

United States v. *Bisceglia*, 420 U.S. 141 ..... 3, 5

United States v. *Coopers & Lybrand*, 550 F.2d 615 5

United States v. *Life Science Church of America*, 636 F.2d 221 5

United States v. *Luther*, 481 F.2d 429 5

United States v. *Morton Salt Co.*, 338 U.S. 632 6

United States v. *Noall*, 587 F.2d 123, cert. denied, 441 U.S. 923 ..... 3, 4, 6

United States v. *Powell*, 379 U.S. 48 6

Constitution and statute:

United States Constitution, Fourth Amendment 3

Internal Revenue Code of 1954 (26 U.S.C.):

Section 7602 ..... 4, 6

Section 7602(2) 4

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MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In this internal revenue summons enforcement proceeding, the court below ordered enforcement of a summons insofar as it requires the production of audit workpapers prepared by independent auditors in the course of certifying financial statements of Amerada Hess Corporation, but held that similarly prepared tax accrual workpapers are privileged from disclosure. The government has petitioned for certiorari (No. 82-687) from the latter aspect of the decision below, and that petition is currently pending before the Court. Although Arthur Young has opposed our petition, it now seeks review of the ruling of both courts below ordering the production of audit workpapers.

The pertinent facts underlying the cross-petition may be summarized as follows: Arthur Young & Company has been Amerada Hess Corporation's independent auditor

since November 1971. In this capacity, Arthur Young's duties included the review and certification of Amerada's financial statements pursuant to federal securities laws. During the course of its audit, Arthur Young prepares workpapers that "consist almost entirely of factual data generated from * * *[Amerada's] books when * * *[Arthur Young] verif[ies] the financial statements prepared by Amerada's own personnel by spot-checking selected bookkeeping entries and records. They include third-party confirmations of transactions, as well as * * *[Arthur Young's] own judgments about the implications of the company's transactions. Some of the work papers contain material learned during the confidential discussions between Amerada and * * * [petitioner's] employees" (Pet. App. 19a, 21a).[1]

In the course of an audit of Amerada's federal income tax returns for the years 1972, 1973 and 1974, the Internal Revenue Service issued a summons to Arthur Young for the production of various categories of documents concerning Amerada Hess (Pet. App. 1a).[2] Upon petitioner's refusal to comply with the summons, the government brought this summons enforcement proceeding in the United States District Court for the Southern District of New York (*id.* at 16a-21a). The court's initial order enforced the summons with respect to all items except the audit workpapers, the

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[1]"Pet. App." references are to the appendix to the government's petition for a writ of certiorari (No. 82-687).

[2]The summons requested, inter alia, the following documents relating to Amerada's tax liability for the years 1972-1974 (Pet. App. 2a):

> Audit program file(s)
> Audit workpaper's file(s)
> Tax pool analysis file(s)
> File(s) prepared during the course of work performed for the "special committee", including agreed procedures, selection process reports, schedules and other workpapers.

audit plan and the so-called special committee reports (*id.* at 15a). The district court subsequently amended its order to require production of the audit workpapers (App., *infra*, 1a-2a).

The court of appeals affirmed the district court's order requiring production of the audit workpapers. It rejected Arthur Young's contentions that these workpapers were not "relevant" to a determination of the correct tax liability of Amerada Hess. In accord with its prior decision in *United States* v. *Noall*, 587 F.2d 123 (2d Cir. 1978), cert. denied, 441 U.S. 923 (1979), the court held that the reliability of a taxpayer's records, as revealed by the audit workpapers, is of legitimate interest to the Internal Revenue Service and therefore "relevant," in order to ensure that the records accurately reflect the taxpayer's income and expenses. The court further rejected petitioner's argument that "the broad, generic document request" violates the Fourth Amendment (Pet. App. 21a-23a). As the court observed, until the Internal Revenue Service knows what information the documents contain, "it cannot describe them with any specificity" (*id.* at 23a).

1. The decision below correctly enforced the summons requiring production of the "[a]udit workpaper's file(s)." Arthur Young makes no claim that this description is unclear, nor has it presented evidence that production of the papers would be overly burdensome.[3] Rather, Arthur

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[3]Arthur Young suggests (Cross-Pet. 16-17) that enforcement of a summons using a so-called generic characterization of records violates the Fourth Amendment as an unreasonable search and seizure. But there is no claim that the demand was unclear or overly burdensome. Thus, the Fourth Amendment is not implicated. See *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 208 (1946). Compare *FTC* v. *American Tobacco Co.*, 264 U.S. 298 (1924). See also *United States* v. *Bisceglia*, 420 U.S. 141, 148 n.2 (1975). Indeed, the court of appeals noted (Pet. App. 22a) that the district court "carefully protected [Arthur Young] from * * * [any particular burden] by requiring the IRS to shoulder the costs and to inspect on site."

Young argues (Cross-Pet. 12) that the use of the term "[a]udit workpaper's file(s)" is a "broad generic request[]" that is "impermissible" and that the Internal Revenue Service should be required to define specifically "its areas of inquiry" (*id.* at 14). But as the court of appeals properly noted (Pet. App. 23a), until the Internal Revenue Service examines the contents of documents, "it cannot describe them with any specificity." Nor can it precisely define areas of concern until it has had an opportunity to investigate. For this reason, Section 7602 of the Internal Revenue Code of 1954 (26 U.S.C.), pursuant to which the summons was issued, authorizes the Internal Revenue Service to summon "such books, papers, records or other data * * * as *may be* relevant or material to [its] inquiry" (26 U.S.C. 7602(2) (emphasis supplied)). As Judge Friendly observed, "Congress acted advisedly in using the verb 'may be' rather than 'is', [sic] since the Commissioner cannot be certain that the documents are relevant or material until he sees them." *United States* v. *Noall, supra,* 587 F.2d at 125.[4]

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[4]Arthur Young agrees (Cross-Pet. 9) that the materials contained in its workpapers are subject to IRS scrutiny and that such papers may contain information that is relevant to the IRS inquiry. It resists disclosure on the ground that the Service should not be able to examine the entire group of workpapers prepared with respect to the taxpayer under investigation.

Despite petitioner's disclaimer (Cross-Pet. 9 n.13), its position necessarily requires the district court to conduct an in camera inspection of each document to determine which are relevant in fact. While a district court may well narrow the scope of a summons in response to a valid claim of overbreadth and exclude various categories of documents, the task Arthur Young's position would impose is indeed formidable. As Judge Friendly stated in *United States* v. *Noall, supra,* 587 F.2d at 127, which the district court quoted with approval (Pet. App. 5a n.4), this task "would be so burdensome and probably so impossible of performance that Congress could not have meant to impose it upon busy district judges."

2. Contrary to Arthur Young's contention (Cross-Pet. 12-14), the decision below does not conflict with *United States* v. *Luther*, 481 F.2d 429 (9th Cir. 1973), *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), or *United States* v. *Life Science Church of America*, 636 F.2d 221 (8th Cir. 1980). While the courts are charged with the responsibility of protecting against overly broad demands (*United States* v. *Bisceglia*, 420 U.S. 141, 146, (1975)), the standard of relevancy determines the reasonableness of the demand. Thus, while the court in *Luther* limited the demand to documents that "reflect the receipt or disbursement of money or relate to financial or property transactions" (481 F.2d at 433), it never proscribed demands for broad classes of records that may be relevant to the determination of taxes. Similarly, in *Coopers & Lybrand*, the court affirmed the district court's findings that the government had not established to the district court's satisfaction that an independent auditor's audit plan and tax pool analysis may be relevant to the Service's inquiry. However, the court did not bar demands for such documents as audit workpapers. Indeed, the court noted that Coopers & Lybrand had produced "all of the work papers involved in the audit program." 550 F.2d at 619.

United States v. *Life Science Church of America, supra*, is likewise inapposite. There, the court vacated the district court's enforcement order and remanded the case for a determination whether the summons for church records was overly broad. The court pointed out that "§ 7605(c) attempts to limit the breadth of IRS summonses issued to churches" and also noted that the "requests could infringe * * * first amendment rights" (636 F.2d at 224). These considerations are not present in this case. In short, the limitations on the scope of the summonses in the cases cited by Arthur Young turn upon factual or other considerations that are not present here. Since Arthur Young concedes

(Cross-Pet. 9) that the workpapers sought may be relevant, the requirements of the statute are met. See *United States* v. *Powell*, 379 U.S. 48, 57-58 (1964).[5] See also *Fisher* v. *United States*, 425 U.S. 391, 394 (1976) (enforcing a summons for " '[r]etained copies of reports and other correspondence' " between the taxpayer and his accountant and " '[a]ccountant's work papers' " (citation omitted).

3. Finally, Arthur Young cites no authority for its contention (Cross-Pet. 14) that the Internal Revenue Service should specifically define "its areas of inquiry." The Internal Revenue Service rarely would know what areas of pertinent inquiry may emerge until it has had an opportunity to review evidence that may be relevant to the determination of tax liability. *United States* v. *Noall, supra*, 587 F.2d at 125. As this Court has noted, the Internal Revenue Service " 'does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.' " *United States* v. *Powell*, 379 U.S. 48, 57 (1964) (quoting *United States* v. *Morton Salt Co.*, 338 U.S. 632, 642-643 (1950)). Thus, the Service's power to investigate is not dependent upon prior identification of issues. Indeed, such a requirement clearly would "stultify the enforcement of federal law." Compare *Donaldson* v. *United States*, 400 U.S. 517, 536 (1971).

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[5]Nor is there any merit to petitioner's suggestion (Cross-Pet. 15) that, when a summons is issued to a third party, the government bears a higher burden of proof, citing, inter alia, *Hubner* v. *Tucker*, 245 F.2d 35 (9th Cir. 1957). *Hubner* was effectively overruled by *CAB* v. *Hermann*, 353 U.S. 322 (1957). See *Foster* v. *United States*, 265 F.2d 183, 188 (2d Cir. 1959). Moreover, neither Section 7602 nor any of this Court's decisions interpreting it draw a distinction between a summons issued to a taxpayer and one issued to a third party.

It is respectfully submitted that the cross-petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

JANUARY 1983

DOJ-1983-01

APPENDIX

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, Petitioner

-v-

ARTHUR YOUNG & COMPANY, Respondent,

-and-

AMERADA HESS CORPORATION,
Respondent-Intervenor

M-18-304 (KTD)

[Feb. 26, 1981]

ORDER AND JUDGMENT

This proceeding having been brought on by petitioner United States of America by order to show cause issued October 9, 1979, to enforce an Internal Revenue Service ("IRS") summons served upon respondent Arthur Young & Company on April 17, 1978, and the Court having issued an opinion dated August 26, 1980, granting the United States' petition in part and denying it in part, and thereafter the Court having granted respondents' motion for reconsideration and upon reconsideration having adhered to and reaffirmed its August 26, 1980, opinion, and petitioner having moved for entry of an order and judgment and for clarification of the Court's August 26, 1980, opinion, it is therefore

ORDERED that the Court's opinion dated August 26, 1980, be modified to delete therefrom the word "workpapers" from the last line of page 12 of the slip opinion and, further, to delete the words "and workpapers" from the fifth line of page 14 of the slip opinion, and it is further

ORDERED that the petition of the United States of America to enforce the IRS summons served upon respondent Arthur Young & Company on April 17, 1978, is granted to the extent set forth below, and it is further

ORDERED AND ADJUDGED that respondent Arthur Young & Company appear before IRS Special Agent G. Robert Armstrong, or his designated representative, at 10:00 A.M., within twenty (20) days of the entry of this order and judgment, at the offices of respondent where the documents to be produced are located or at an alternative location to be agreed upon by the Special Agent and respondent, then and there to be sworn, to give testimony and to produce for examination and copying the books, records and other papers demanded in the IRS summons served upon respondent on April 17, 1978, with the exception of item "11", the audit program file(s); item "12", the audit workpapers file(s) but only to the extent that the audit program is contained within these file(s); and item "14",the Special Committee workpapers, the examination to continue from day to day until completed.

Dated: New York, New York
February 23, 1981

/s/ Kevin Thomas Duffy

UNITED STATES DISTRICT JUDGE